Tata Sponge Iron Limited

January 05, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan^	304.35	304.35	[ICRA]AA (Stable); Reaffirmed
Fund Based – Cash Credit	110.00	110.00	[ICRA]AA (Stable); Reaffirmed
Non Fund Based Limits	313.15	313.15	[ICRA]A1+; Reaffirmed
Total	**727.50**	**727.50**	

^proposed

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) to the Rs. 304.35-crore proposed term loan and Rs. 110-crore fund-based limits of Tata Sponge Iron Limited. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 313.15-crore non-fund based bank facilities of Tata Sponge Iron Limited (TSIL)[1]. The outlook on the long-term rating is 'Stable'.

Rationale

The reaffirmation of the ratings takes into account TSIL's highly conservative capital structure, its strong debt-protection metrics and a comfortable liquidity position, given a large cash balance and liquid investment portfolio, which impart a high degree of financial flexibility to the company. ICRA also notes the improving demand scenario for sponge iron in the country, which has resulted in an increase in sponge iron realisation in the current year, thereby improving the operating profits of the company. In FY2017, however, the demand scenario for sponge iron was weak, but the impact was limited to an extent by the benign raw material price scenario. ICRA notes that TSIL would be exposed to project-related risks, given that it has large capital expenditure plans relative to its current balance sheet size, to be implemented over the medium to long term. Going forward, ICRA would continue to monitor the performance of the company with respect to its core sponge-iron operations, which remains exposed to the cyclicality inherent in the steel industry, as well as the company's phasing of the capital-expenditure plans over the years and funding pattern for the same.

The ratings, however, continue to reflect TSIL's established position in the domestic sponge-iron industry, its status as a 54.5% subsidiary of Tata Steel Limited (TSL) and its strong operating profile characterised by superior quality of produce that allows the company to command a premium over prevailing market rates. The ratings are also supported by the presence of captive power-generation facilities that reduce TSIL's operational costs. Income from sale of power and returns on investments provide additional sources of revenue, which are relatively more stable than the cash flow from the commodity sponge iron operations.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

Outlook: Stable

ICRA believes that the outlook for Tata Sponge Iron Limited will continue to remain stable.

The outlook may be revised to 'Positive' if substantial growth in revenue and profitability strengthens the financial risk profile of the company. The outlook may be revised to 'Negative' if the sponge-iron industry goes into a downturn, adversely impacting profits and cash flows significantly.

Key rating drivers

Credit strengths

Healthy operations and profitability – TSIL has a long track record in the sponge-iron business, with an annual capacity of 425,000 tonnes per annum (tpa). The company has two power plants based on waste heat generated from the kilns with a combined generation capacity of 26 MW, which ensure availability of power at a low cost. During FY2017, the company produced 3,90,000 MT of sponge iron (at 100% of rated capacity) and, through debottlenecking of all the kilns, improvement in quality of raw materials procured and optimisation of processes, the company has been able to increase the effective capacity of sponge iron production from 390,000 MTPA to 425,000 MTPA.

Operating margins rose in FY2017 to 11.07% on account of lower iron-ore cost despite a decline in sponge iron realisations. Subsequently, in H1FY2018, with an increase in sponge iron realisations, the margin has sharply improved to 21.31%. The net profits of the company were supported by sale of power and non-operating income from its investments. The net profit margin for TSIL has followed the trend in operating margins, from 10.53% in FY2017 to 16.98% in H1FY2018.

Debt-free status - TSIL has remained a debt-free company since FY2011. This acts as a credit positive for the company that operates in an industry, exhibiting cyclical trends. TSIL's conservative capital structure has translated into strong debt-protection metrics for the company, which is reflected in OPBDITA/Interest & Financial charges of 124.02 times during H1FY2018. ICRA notes that the current debt-free status imparts a high degree of financial flexibility to the company. ICRA expects TSIL to remain debt free over the next two years.

Comfortable liquidity position - Liquidity position of the company remains comfortable as is evident from healthy accruals with no debt obligations and cushion on working-capital limits, with unutilised fund-based limits and moderately utilised non-fund based limits. As on September 30, 2017 the company had a cash balance of Rs. 343.17 crore and liquid investments of Rs. 247.66 crore.

Strategic location of the manufacturing facilities positively impacts the company's cost structure - Given the raw-material intensive nature of the business, proximity to sources of raw materials provides an advantage to sponge iron manufacturers. In this context, TSIL's manufacturing facility is favourably located at Joda in Keonjhar district, Odisha, an area with rich reserves of iron ore. Moreover, proximity to the iron-ore mines ensures that the company is well placed in terms of its freight costs, thereby, positively impacting its cost structure. The company procures its iron ore from TSL's mines operating in Odisha at a discount to prevailing market rates, which provides it with a competitive edge.

Credit challenges

Margin sensitivity to price trends of sponge iron and key raw materials – Sponge iron is an intermediate commodity, the price of which shows high volatility. TSIL's margins remain susceptible to the risks of mismatch between raw material and sponge iron prices. TSIL imports 95% of total non- coking coal requirements from South Africa. Use of high quality international coal resulted in a decline in specific consumption of coal in FY2017, but the same has been negated to an extent with the increase in international non-coking coal prices. ICRA notes that high reliance on imported coal exposes TSIL's profitability to fluctuations in international non-coking coal prices as well as fluctuations in USD-INR exchange rate.

At present, the company has a coal linkage of 24,000 MT from Eastern Coalfields Limited. Moreover, in order to improve its raw material security, TSIL had taken steps towards integrating backwardly into captive coal mining. The company was earlier allocated the Radhikapur (East) coal block with reserves of around 115 million tonne, which was later de-allocated by the Supreme Court.

Large capital expenditure plans, though at a nascent stage at present - TSIL has received in-principle board approval for setting up a steel plant of up to 1.5 MTPA, in phases, at Kenojhar, Odisha, subject to the financial viability of the project. ICRA thus notes that the company is exposed to significant project-related risks in the medium term, given that it has large capital-expenditure plans relative to its current balance -sheet size. However, TSIL's highly conservative capital structure, its strong debt-protection metrics and a comfortable liquidity position, given a large cash balance and liquid investment portfolio, are likely to impart financial flexibility to the company.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Entities in the Ferrous Metals Industry

About the company:

Tata Sponge Iron Ltd. (TSIL) was originally set up as a joint venture between Tata Steel Ltd. (TSL) and Industrial Promotion & Investment Corporation of Orissa Ltd. (IPICOL) in 1982. At present, TSIL is a 54.5% subsidiary of TSL. The company is one of the early entrants in the domestic sponge-iron industry, with its plant located in Keonjhar district of Odisha. TSIL's sponge iron capacity is 425,000 metric tonnes per annum. The company is self sufficient in its power requirement, with a 26-MW captive power plant running on the waste heat gases produced in the sponge iron kiln.

In FY2017, on an audited basis, the company reported a net profit of Rs. 58.74 crore on an operating income of Rs. 557.60 crore compared to a net profit of Rs. 31.89 crore on an operating income of Rs. 575.02 crore in the previous year. In H1FY2018, the company reported a net profit of Rs. 58.16 crore on an operating income of Rs. 342.56 crore.

Key financial indicators (audited)

	FY 2016	FY 2017	H1 FY2018
Operating Income (Rs. crore)	575.02	557.60	342.56
PAT (Rs. crore)	31.89	58.74	58.16
OPBDIT/ OI (%)	4.38%	11.07%	21.31%
RoCE (%)	7.40%	12.45%	23.75%
Total Debt/ TNW (times)	-	-	-
Total Debt/ OPBDIT (times)	-	-	-
Interest coverage (times)	4.68	25.26	124.02
NWC/ OI (%)	-4.28%	-4.00%	0.61%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating Jan 2018	Date & Rating in FY2017 Jan 2017	Date & Rating in FY2016 Dec 2015	Date & Rating in FY2015 Dec 2014
1	Fund Based – Term Loan^	Long Term	304.35	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Fund Based – Cash Credit	Long Term	110.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Non Fund Based Limits	Short Term	313.15	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

^Proposed

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Term Loan^	NA	NA	NA	304.35	[ICRA]AA (Stable)
NA	Fund Based – Cash Credit	NA	NA	NA	110.00	[ICRA]AA (Stable)
NA	Non Fund Based Limits	NA	NA	NA	313.15	[ICRA]A1+

^Proposed

Source: Tata Sponge Iron Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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